

Bench date: February 6, 2001

TELECOMMUNICATIONS DIVISION STAFF REPORT

01-0128

February 1, 2001

SUBJECT: Commission Investigation of SBC/Ameritech Merger Related Costs and Savings.

I. Capsule Summary

In Docket 00-0260, Ameritech Illinois' annual price adjustment filing, the Commission ordered that a separate docket be initiated to address merger related costs and savings upon completion of the independent audit. Barrington Wellesley Group, Inc. ("BWG") provided its final report to the Commission on January 8, 2001. Staff recommends that a docket be initiated to investigate merger related costs and savings allocable to Illinois.

II. Background

The Commission's order in Docket 98-0555 approving the merger of SBC and Ameritech addressed merger-related costs and savings through condition 26. Condition 26 required retention of a third party auditor to develop accounting standards and to assist the Commission in tracking merger related savings as determined by this order. The Commission's Order was subsequently amended to provide that certain costs, including relocation and severance costs, were one-time costs that should not be netted against merger related savings. Specifically, the Amended Order states:

"As for the meaning of "costs", the Commission agrees with Staff that none of the merger "transactional costs" shall constitute legitimate costs for present purposes. "Transactional costs" shall be defined as those costs and expenses incurred in connection with the merger transaction and shall include but not be limited to fees and expenses of financial advisors and consultants and lawyers; filing fees; proxy costs; the costs of securing regulatory approval of the transaction; employee retention payments; employee change in control payments; employee severance costs; employee relocation costs; the costs of third party auditing or technical assistance necessary to comply with the conditions imposed by

the Commission in this Order; the administrative costs associated with the Consumer Education and Community Education funds; and the costs of penalties should conditions and benchmarks imposed by the Commission in this Order not be met. It is only these costs directly associated with AI's provision of service which qualify under Section 7-204(c). Hence, we agree with Staff's position to allow recovery of only those costs directly associated with the utility's operation."

BWG was retained by the Commission and submitted its final report on January 8, 2001. The final report includes a list of recommendations for the Company. (SBC is expected to provide its response to the BWG report coincident to release of the report by the Commission following formal presentation on January 30, 2001.) The BWG report also contains a list of policy issues for the Commission, the resolution of which will impact the amount of net merger related savings reported in future years. Resolution of these recommendations and policy issues and determination of the net merger savings attributable to calendar 1999 support Staff's recommendation that the Commission ordered docket be initiated immediately.

It is also important to note that SBC has not yet allocated any year 2000 merger costs and savings to Illinois and maintains that it is not required to do so prior to its April 1, 2001 price cap filing. Therefore, its allocation procedures have not been tested with the use of actual data. BWG's final report also includes a list of future audit issues to be resolved once Ameritech files its year 2000 Cost and Savings Report on April 1, 2001. Staff is currently soliciting bids for the audit of year 2000 data and anticipates that project will not be completed until approximately October 1, 2001. Staff notes that there is no provision that would allow retroactive recovery of net merger savings and, therefore, recommends that either an interim or final order determining actual 1999 net merger savings and addressing the policy issues be entered as soon as practicable.

BWG's Final Report also states that SBC/Ameritech does not consider all employee severance and relocation costs to be transaction costs. Portions of these costs were included in the 1999 merger implementation costs reported to the Commission as an offset to merger savings. (BWG Final Report, page VII-38). Staff believes that the Commission's amended Order is clear and that no pre-merger costs; transaction costs, including employee severance and relocation costs; or costs of compliance with merger conditions should be netted against merger savings. It is appropriate for the Commission to re-iterate its finding provided above and limit the scope of this proceeding to issues not previously addressed by the Commission.

III. RECOMMENDATION

Staff recommends that the Commission initiate a docket to address SBC/Ameritech merger related costs and savings at this time.

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